

Lettres de Byblos
Letters from Byblos

No. 19

YARA SAAB
WITH A CONTRIBUTION BY NILS GOLDSCHMIDT

**Social Market Economy: A Concept for Reform in the
Near East?**

A Conference Report

Centre International des Sciences de l'Homme
International Centre for Human Sciences

Byblos 2007

Lettres de Byblos / Letters from Byblos

A series of occasional papers published by

UNESCO Centre International des Sciences de l'Homme
International Centre for Human Sciences

The opinions expressed in this monograph are those of the author and should not be construed as representing those of the International Centre for Human Sciences.

All rights reserved. Printed in Lebanon. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or any information storage or retrieval system, without permission in writing from the publisher.

© International Centre for Human Sciences, 2007

Published in 2007 in Lebanon by the International Centre for Human Sciences,
B.P. 225 Byblos (Jbeil), Liban.

ISBN 978-9953-0-1119-6

Session I: Foundations for understanding how market and governments work
from the perspective of “constitutional economics”
Presented by Professor Viktor J. Vanberg

Professor Viktor J. Vanberg, director of the Walter Eucken Institute in Freiburg, argued that those who focus solely on the process of distribution of wealth assume that it simply exists in and of itself, and ignore the fact that wealth is to be created and constantly produced. What are the conditions that are favorable or unfavorable to produce wealth? Two different types of strategies are to be envisaged:

- 1- Socially productive activities (production, voluntary exchange...)
- 2- Socially unproductive activities (predation/defense against it).

The latter are productive activities if considered individually, but they don't increase the aggregate wealth of communities. In fact, investing in security against predation takes place without increasing the wealth that is currently available. This directly relates to what the speaker referred to as the “anarchy problem”: in a world where no rules are respected, how can we decide for strategies and invest in defense? Societies can eliminate predation and plunder, but resources should ideally be shifted from socially unproductive to productive activities. According to David Hume who proposed the principle of Reciprocity in the 18th century, equal treatment teaches cooperation and leads to socially productive interactions. The Tit-for-tat mechanism, manifested in the prisoner's dilemma strategy provides further explanation.

Two players are mutually better off cooperating even if the incentive to defect exists, as long as both parties collaborate. The spontaneity of mutual behavior thus leads to cooperation and reduces predation and plunder. The speaker recognizes this strategy's limited effectiveness, as it only applies to those engaged in direct mutual interaction. Families, local villages and tribes are examples of spontaneous cooperation that nonetheless leads to the fragmentation of society into groups unable to cooperate beyond these limits. It thus affects the capacity to produce wealth.

Foundations of Economic Wealth

So what are the foundations of economic wealth? In his famous work, the “Wealth of Nations”, Adam Smith asserted that “the division of labor is limited by the extent of the market”. Indeed, the increase of wealth over the last 250 years has been tremendous; Smith explained this phenomenon by the increase in human productivity thanks to the division of labor. The essential ingredient for sustained economic progress is the division of labor and specialization. Moreover, the extent of the market is essential, as it defines exchange opportunities. *The bigger the market, the more exchange opportunities, the more increase in division of labor.* For instance, the wealth produced in Hong Kong greatly surpassed that of other parts of the world because Hong Kong had no resources; its natural foundation was a large number of people and a solid network of external trade. The extent of the market therefore led to the division of labor, itself leading to the productivity needed for growth. How can the exchange network be expanded while sustaining social bonds? Adam Smith's argument is that the extent of the market depends on:

- 1- Technological advancement: wheels, roads and communication technologies motivate individuals to engage in trade activities.
- 2- Legal security: the protection of rights is necessary for trade and exchange, as the law protects against predatory behavior either by thieves or by the State.

Exchange Types

James M. Buchanan advocated for a social contract leading to an organized State that solves the anarchy problem. Furthermore, Douglass North argued that the existence of the State is a necessary precondition for modern economic growth, as the legal order promotes the extent of the market. The following types of exchange are observed:

- 1- personal exchange
- 2- Impersonal exchange without third party enforcement
- 3- Personal exchange with third party enforcement (the State)

In most transactions, exchange is not of a simultaneous nature, so trust becomes an integral condition to the relationship which binds the two parties. Personal exchange involves enough trust requiring low transaction costs (lawyers, notaries, contracts...). On the other hand, impersonal exchanges need special safety conditions. Unknown partners require special measures for every transaction. Even if production costs are low thanks to the increase in the size of the market, transaction costs are still high, as third party enforcement is required for the success of the exchange. Today, the shadow of the law in the appropriate State makes exchanges a cost saving enterprise thanks to economies of scale. The transaction costs hence become relatively low while providing protection and enforcement.

The State: a double-edged sword

Dr. Vanberg asserted that there is no place on earth without State control: wealth is tremendously different in various parts of the world and the State is a necessary but insufficient structure for modern economic growth.

In unproductive activities, strategies of enrichment can be either in the form of private or public predation, with the State being a potential instrument of plunder of the citizens. The State can either be predatory in itself or a source of predation. If lobbying the State takes place for private benefits, rent is thus sought to increase the competitiveness of one's own product at the expense of the consumers' purchasing power. Lobby organizations are socially unproductive as they seek private privileges or prevent others from acquiring them.

North argues that the State is a double-edged sword: it is indispensable, yet its potential danger is always present. It can be an inhibitor of trade and an instrument of public predation. It can either be in the form of exploitation of citizens by bureaucrats or mutual exploitation of citizens to get benefits at the expense of others. Interest groups therefore perceive the State as a privilege-granting agency and seek rent in two ways:

- 1-protectionism against foreign producers: exploitation of consumers or producers by other producers.
- 2- Subsidies: exploitation of taxpayers by producers/beneficiaries of subsidies.

What follows is a so-called “Rent-seeking/privilege-seeking dilemma”: would one rather live in a liberal order without any privileges or a protectionist system riddled with privileges and protectionist restrictions? According to North, there are enough reasons to opt for a liberal order, one characterized by a “constitutional economy”.

Constitutional Economics:

Economics explains how people can realize mutual benefits from voluntary exchanges. The market is perceived as a protected arena where property rights are respected and the transfer of goods takes place based on mutual voluntary consent that is favorable to both parties, be it from complex exchanges or joint commitments.

Constitutional economics is based on the “Gains from Trade” paradigm. Consider a comparison with a football game: what is seen on the football field reflects the rules of the game. The rules have been modified to make it most entertaining for spectators while improving the game. When complaints that too few goals are kicked making the game less attractive are expressed, is the abolition of the off-side rule appropriate? The rules affect the play of the game. The focus on constitutional economics is how people can improve their social game by adjusting the relevant rules.

Textbooks deal with markets as if they were natural events; in reality, there are institutional preconditions for the markets to function properly and they are dictated by the rules. A well-functioning market should prioritize consumers over producers to render the latter more responsive to the needs of the former. A producer can very well reap benefits without putting consumers at a disadvantage if the State sets the appropriate legal framework. The more producers are responsive to citizens’ needs, the more citizen sovereignty is enhanced.

Enhancing democracy

John Rawls sees democratic polities as “cooperative ventures for mutual advantage”, where the individual’s interest lies in realizing gains from participation in a collective enterprise. However, one’s own interest is at risk of being exploited by political agents (principal-agent problem) and by other citizens. The task of the political constitution is thus to balance the prospects of mutual gain and the risks of interest violations, while its designed is employed to create a framework of rules that performs well according to these criteria. The role of constitutional constraints is to limit the governments’ authority and capacity to grant privileges. The western constitutional tradition is based on a rule system that reduces the risk of one power encroaching on others and constrains privilege-seeking, for instance through the division of power, bicameralism, federalism and judicial review. To further improve constitutional provisions, the following can be done:

The political economist Hirschman talks of “Exit, Voice and Loyalty”. The means of controlling the treatment received by members of a certain organization are two sorts of responses:

- 1- Voicing of a protest with the objective of getting better treatment.
- 2- Exiting while walking away.

In general, the market response is usually an *exit* once dissatisfaction is felt. In politics, however, the response is one of *voice* because of the predetermination of the results of a political structure. The effectiveness of *voice* in politics is low; however *exit* functions well in the market and helps to maintain competition. In turn, competition is defined as the accessibility of alternative partners as opposed to a monopoly. The smaller the jurisdiction is, the easier it is to change as a result of the dissatisfaction. If the system is constructed to protect against political mistreatment, it should be made easier for citizens to escape the system. In this sense, that is why the speaker finds himself opposed to a united system of policies in the EU because it limits the effectiveness of *voice*.

The role of competition affects politics as a disciplinary measure towards politicians in two forms:

- 1- Competition for government office: The rules for the organization of government, elections, the party system and the degree of the freedom of the press.
- 2- Competition between governments: globalization leads to competition between different jurisdictions and federal States. Subsidiarity becomes an incentive mechanism by pressuring governments to act in favor of their citizens.

Conclusions:

Constitutional economics is concerned with the following:

- 1- Human welfare and the gains from the trade perspective;
- 2- Market and State as social arrangements for mutual gains;
- 3- The constitution of markets: competition under constitutional constraints and consumer sovereignty;
- 4- The constitution of politics: democracy and citizens' cooperation and citizen sovereignty.

Plenary Discussion

Applicability of the model

When asked whether or not the western model is applicable to the Arab world, bearing in mind that the only major means of production is oil, Dr. Vanberg argued that the potential of production does not depend on natural resources but intellectual capacities. The release of entrepreneurial spirit in the right political and institutional environment can lead to the production of practically anything. The example of Hong Kong proves that the production of a huge diversity of items is due to imagination. The Arab world has to be seen within the perspective of political and legal factors and the identification of inhibitors of entrepreneurial activity, and not productivity in itself. In fact, affluence of natural resources may lead to a tendency of neglecting other capacities of production. A comparison between Lebanon and Switzerland shows that the latter fought its last war in 1848, and has since established a solid administration and a political set-up. There is no reason why Lebanon cannot follow the same path.

Protection to all

Compromising the rights of workers who are displaced and the development of technology was seen as problematic. What kinds of rules are conducive to growth in a social manner? The producers are willing to submit to the discipline of competition and to serve consumers even if they are not fully satisfied. But individuals are typically involved in the economy in both capacities of producers and consumers. Producers are interested in the protection of the State and support its intervention, whereas consumers are interested in being served as cheaply and efficiently as possible while benefiting the whole community. Anticompetitive measures serve only special interests, and the adoption of a market system will render both consumers and producers better off.

Technology plays an important role. For instance, a book keeper in India can do the bookkeeping for an insurance company in Germany, thus allowing the insurance company to sell its service at cheaper rates, benefiting the consumers as well.

The problem of job alienation in Adam Smith's advocacy of division of labor was addressed. According to the speaker, the process clearly serves consumers as they receive new, better and cheaper products. Technological development takes place constantly, so how should it be dealt with? As stopping progress is not a viable solution, the alternative is to enter into a contract while being aware that occasions when our interests will be compromised are to be faced at some point. In a social community, assistance to individuals who are harmed by measures of rehabilitation is necessary to ensure their re-entry into the job market. The individual is the measurement of what is a desirable social arrangement. If two persons engage in a transaction, then it is carried out for their mutual benefit. We can think of interest groups as conglomerates of individuals. The point of organizing is to get a unit that is able to organize itself and form a community.

Democracy is seen as a system where people enjoy rights and responsibilities equally. As consumers, we don't have conflicts of interests. If you understand that you can get subsidies from the government, you would invest energy and resources in lobbying the government for subsidies. Old, dying industries are the ones that ask for governmental support after realizing their failures. The speaker opts for rules that disallow the government from promoting such behavior.

The question of monopolies as a beneficial structure arose. Though in general monopolies are counterproductive because they inhibit the *exit* strategies, natural monopolies are there to provide basic services to citizens not for the sake of profit but for the welfare of all. The speaker responded that a sophisticated approach is to realize that many supposed natural monopolies are not entirely of that character. The modern policy is to preserve the infrastructure within the hands of the government but assign operation in a competitive fashion; most modern electricity providers function as such.

Development and the role of the government

Some participants challenged the analogy drawn between the economic and political sphere, and wondered whether it was truly a realistic comparison. Dr. Vanberg explained that analogies are drawn in order to emphasize a particular comparable aspect, without the intention of proving that they are identical. In politics, not every consumer can have his or her own product (there is only one president, for instance). This is not the case in the market. So how can we organize ourselves to opt for one solution while being

responsive to different interests? When considering politics as an institutional arena for the creation of mutual benefits, we should opt for what is more conducive to common benefits rather than specific interests at the expense of others.

What comes first, economic development or democracy? Dr. Vanberg asserted that there is no general recipe. In order to reach economic prosperity, a secure legal framework is needed, property rights need to be protected to promote investment, and a reliable mode of implementation of contracts should be available. In other words, rule of law should characterize the economy. For instance, a dictatorship can implement institutional structures that allow for economic growth. But how is the implementation of growth-inductive mechanisms by dictators guaranteed, knowing that an authoritarian regime is known for its lack of responsiveness to the overall desires of the population?

Economic growth is not an unquestionable goal for policy. If a functioning democracy means that the common interest of the people is executed, then if what they choose reduces economic prosperity, then their wishes should be granted. Many countries opt to maintain the landscape as it is, and there is no reason why that choice shouldn't be respected.

Participants contested that the decision-making process, especially in developing countries is seldom restricted to domestic pressures. They are influenced by foreign factors, be it States or international organizations. The speaker explained that among economists, the effect of institutions such as the WTO or the World Bank is disputed. He challenged the statement that such bodies interfere negatively in domestic economies. He insisted that they protect against governmental intra-national protectionist policies and predation.

Participants challenged the negative implication associated with the terminology of predation, and questioned its applicability to redistribution mechanisms that allow for mobility of capital from the rich to the poor. The speaker clarified that being against predation does not mean opposing redistribution. On the contrary, a State has an integrative role, and citizens should enjoy a mutual insurance regime that is beneficial to all, as long as the same rules apply. Redistribution mechanisms are indeed to the interest of the whole community, as no one would prefer to live in a society where people are dying from hunger in the streets.

Session II: Social Market Economy: The Origins of the Concept Presented by Dr. Nils Goldschmidt

Dr. Goldschmidt, from the Walter Eucken Institute in Freiburg, was concerned with providing a focus on the Freiburg School and explaining the theoretical background of the social market economy, an economic order established in Western Germany after World War II as a *mélange* of social and political ideas. The liberal concept sees a direct link between well-functioning markets which leads to efficiency through competition, resulting with economic development and social improvement. The Invisible Hand of the market has to be coupled with an economic constitution provided by the State, a framework that provides the visible hand of the law. This is not to say that the State is expected to intervene in the markets; it neither suggests that a *laissez-faire* type of minimalist State is advocated for either. The State should be strong enough to protect against privilege seeking by formulating general principles, yet distinguished from totalitarianism, as its function is not natural, but a necessity for the provision of people's interests.

Over the Years

Adam Smith did not recognize the necessity of the State for a functioning market. Three main German godfathers of the Social Market Economy were introduced: Ludwig Erhard; Alfred Müller-Armack and Walter Eucken. The opposition of the Freiburg School members to Nazi National Socialism instigated in 1933 stemmed, from their conception of freedom as a norm of academic work, and from their belief that freedom is a key element of social and political life. Taking historical events into consideration, it is no surprise why a freedom program had materialized: The threatening loss of freedom, first within academia and then everyday life inspired the development of an economic and social order required to defy power and coercion.

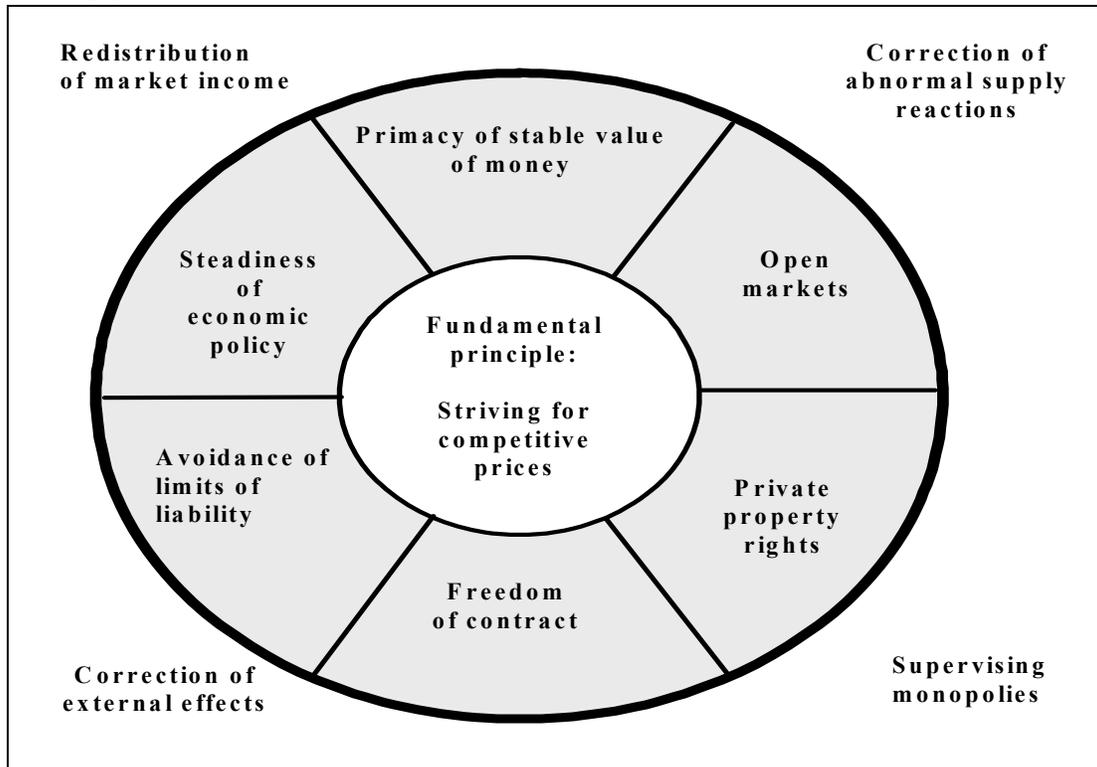
Basic Tenets of Ordoliberalism

Eucken, the architect of Ordoliberalism, was concerned with the problem of private power in a free society, highlighting the legal aspects of economic questions and the interdependence of both orders. The legal order was explained as an economic constitution that is reached by a collective decision-making process. Ordoliberalism granted precedence to the order over economic freedom.

The Freiburg School is an independent strain of neoliberalism which focuses on the connection between freedom and order, as opposed to the American version of neoliberalism. It involves a special research method, one that pointedly distinguishes or isolates abstraction, and is influenced by Max Weber and Edmund Husserl.

The thought process begins with a look at characteristic elements of economies in reality and moves into an identification of general criteria or "ideal types". Abstraction is thus used to bridge the gap between theory and reality through reductionism. In order to capture concrete economic events that shape human life, a dataset of economic facts and of pure economic forms is needed. Every historical economy can be characterized by specific pure forms that can be found by abstraction.

Further, economies can be categorized under two different forms: centrally administered and markets, of which every other form is just a variation. Supply and demand can take on the form of competition, partial oligopoly, oligopoly, partial monopoly or monopoly. The competitive order without the following seven constitutive and regulative principles will simply not work.



Eucken adopted an integrative approach, whereby every economic measurement is socially important and vice-versa. In this sense, a healthy economic constitution lies behind a healthy economic system that begets social improvement.

Shortcomings

The speaker admitted to shortcomings of the theory and proposed to use them to further improve the school of thought. Does the theory meet the demands of modern social science? Dr. Goldschmidt described it as somewhat static in nature. The assumption that implementation of the seven principles will solve economic problems was put into doubt. Another problem to discuss is to the collection and analysis of the dataset, especially when isolated from the political-strategic behavior of the actors is ignored. The politicians' own interest is, as in public-choice theory, a determinant factor that should be taken into account. Finally, a call for approaching international dimensions of economics was formulated in order to meet the standards of modern economic theory.

Plenary Discussion

Linking the past to the present

The participants asked whether the resistance to the Nazi regime was limited to economic reasons or extended to the political sphere as well. The speaker clarified that it was motivated by ideological reasons that opposed the inhumane policies adopted especially pertaining to the pogroms. How could we come to a policy which can enable freedom in a broader sense and aim? The Nazis had no clear economic policy. To overcome the problems of the labor markets, they prepared for war and consequently opted for a war policy. The ideas of a social market economy were born for a society that is to follow the fall of the Nazi regime.

The principles applied in Germany after World War II were dependent on a very specific turn of events. Could they be transferred to other parts of the world today? Dr. Goldsmidt responded by referring to the pillars of Ordoliberalism, which grant precedence to order over freedom. While Thomas Friedman would propose that freedom trumps order, Ordoliberals attempt to find the elements of an ideal order where an appropriate constitution is fundamental to the freedom of individuals.

The historical school skillfully described what had happened in the past but did not depict the individual situations, whereas Ordoliberalism tries to bring in some ideas of ideas of neoclassical economics to market economics while also looking for solutions. Ordoliberals were strong opponents to Keynesian economics because they believed that it lead to interventionism. Nowadays, there exists a chance for Ordoliberals to keep up with the changes of the economic theories' landscape. With the right constitution and rules, the problems of business cycles, a result of bad economic policies, should be avoided, as market imperfection is a result of the rules and not of the role of the State in the market. The Ordoliberal approach aims at solving the social question, not at improving markets or reaping more gains by production or the collection of Foreign Direct Investment (FDI). The focus and the starting point is a social and humane concern; the individual should enjoy the freedom to live the way he/she wants within the appropriate order, as opposed to Nazism that eliminated private decisions. The EU has regulations but lacks the Ordoliberal principles. On the other hand, Germany reformed its economy after the fall of the Berlin wall by rethinking Ordoliberal principles while taking into account the historical to cultural components.

The influence of the United States

The idea of an independent Central Bank was a result of Ordoliberalism and its influence on the German tradition. Some authors argue that recovery is a natural process and not a result of specifically adopted policies. Another argument is that the Marshall Plan was necessary for the take-off and the success of the German economy. The speaker contended that in fact the US did not know what economic order should be established in Germany and were even hesitating to establish a market economy. Futhermore, the US did not express support for reforming the currency and liberalizing prices simultaneously. It is clear that the Marshall Plan was very indispensable for German economic take-off, but without an economic constitution, the cash flowing from the United States would not have been employed that advantageously. The Marshall Plan was a policy directed

towards all Europe and not just Germany. Comparing the growth of Italy with Germany's would prove that a proper policy to manage the resources heavily influences the outcome and the use of foreign capital.

The role of the Government

What is the difference between state-owned and private-owned enterprises? An economic argument would be Von Hayek's. It is more than doubtful that the State has better information than the people in a market economy. Citizens enjoy the local knowledge and the courage to take initiative. Why should a class of politicians have a better idea about improving the economy than those who are on the field?

Inflation always has a worse effect on those who are less wealthy. In the Weimar Republic, high inflation necessitated stable prices and proper non-inflationary monetary or fiscal policies that are unsocial by their nature.

With regards to the accountability of the Central Bank, Dr. Goldschmidt insisted that the Bank has only one task, to stabilize prices. It should not interfere in issues of unemployment or the formulation of economic policies. This is due to the interference of the political arena, as it becomes risky when politicians define its aim and role and manipulate its outcomes.

Shortcomings

The speaker maintained that the Ordoliberal approach however depends too much on a harmonious approach. After World War II, an agreement on certain principles was reached unanimously, a case that is not noticeable today. But Ordoliberal theory can be used as a yardstick. Conflicts within a society can be dealt with through the constitution as a reference point, thus enhancing constitutional dialogue between different interest groups equally abiding by the same legal and political system.

When asked about the single currency for newly entering members to the EU, Dr. Goldschmidt explained that the debate surrounded the order of events: should economic tools be used for political integration or should potential or new members be given the opportunity to develop on their own? Ordoliberalism cannot answer this question.

The problem with the theory is its assumption that man is a rational economic human being, based on no social input to ensure its validity. But the *Homo Economicus* assumption is not really a pillar of the School, as individual psychology and social improvement is often taken into consideration.

While Eucken looked for pure forms, the future of Ordoliberalism depends on looking at economics in different cases to get comprehensive tools identifiable in reality, one that is made up of unlimited variations of economic relations.

Session III: Shared Mental Models, Catch-Up Development and Economic
Policy-Making

Presented by Dr. Joachim Zweynert

The aim of Dr. Zweynert (HWWI in Erfurt) was to explain through his presentation how the concept of Ordoliberalism was put into practice in Western Germany after World War II, and whether or not it could be applicable in other countries. Russia was to be used as an example for the applicability of the Social Market Economy in a different context. His main thesis was that the concept of social market economy cannot be simply transferred to other countries and contexts without taking into account the specific prevailing factors of the country in question. The two previous presentations had provided the “hardware” for this concept while Dr. Zweynert was concerned with the “software”.

Shared Mental Models

Though the assumption of economists is that the individual is a *Homo Economicus*, the truth is that she/he is less rational than we assume. The environment we live in is too complex to understand and therefore motivates us to create mental models to be able to understand it.

According to Denzau and North, mental models are internal representations that individual cognitive systems create to interpret the environment. A shared mental model is thus “the shared framework of mental models that groups of individuals possess which provide both an interpretation of the environment and a prescription as to how the environment should be structured.” They are characterized by both a positive dimension that assists in explaining a particular environment and a normative one that paves the way for what ought to be done.

Formal and informal institutions should be distinguished: while laws provide the formality, codes of conduct are informal in the sense that they reflect historical traditions and are thus difficult to change rapidly as they are deeply rooted in a society’s culture. Mental models, influenced by a religious tradition, would fall under the latter category,

Rapid institutional change produces a gap between mental models and economic reality that is problematic because the discrepancy appears between quickly changing formal institutions and slowly changing informal institutions, reflecting a society’s shared history. The speaker maintains that a politically implemented economic structure which is incompatible with the cultural and intellectual traditions prevailing in that society will, in the long run, either be modified according to the prevailing shared mental models or will be completely replaced by a different type of economic order. In other words, if a successful reform is the objective, the prevailing mental model cannot be ignored.

Dr. Zweynert established a comparison between Germany and Russia, though one should not overemphasize the historical parallels. Four similarities were drawn:

- 1- In the 19th century, both Germany and Russia underwent catch-up development. They endured economic, political and military pressure to imitate the more

- developed countries in their respective surroundings. For instance, all economic policies in Russia changed after defeats and wars that resulted with pressure to imitate development strategies in England, France and Netherlands. The same phenomenon is observed in today's developing countries.
- 2- Both Germany and Russia's shared mental models were traditionally anti-capitalist.
 - 3- Both countries went through a period of totalitarianism in the first half of the 20th century. Their experiences were quite different, but Stalinism and Nazism are comparable.
 - 4- Once they had decided in favor of market reforms, they were led to take into account the influence of foreign sponsoring countries and institutions (the IMF, World Bank and Allies)

Shared Mental Models and Catch-Up Development

What distinguishes these two countries, however, is that Germany's success lies within political elite's awareness of the ideological dimension whereas it was completely ignored in Russia. Economists tend to divide the economic process from reality, affecting their perception of transitions and market reforms. In 1944, Karl Polanyi stated that "A self-regulating market demands nothing less than the institutional separation into an economic and political sphere. ... It might be argued that the separateness of the two spheres obtains in every type of society at all times. Such an inference, however, would be based on a fallacy. ... Neither under tribal, nor feudal, nor mercantile conditions was there ... a separate economic system in society." In fact, the speaker argued, the key characteristic of every modern Western society is the clear separation between different spheres in the society insuring economic, scientific and judicial autonomy from politics. The scientific system is independent from the political system. Conversely, a typical character of a totalitarian system is the dominion of political logic over different institutions mainly through economics. Lack of an economic rationale denies the existence of a functional economic system.

Two perceptions within economics are advocated by Westernisers on the one hand and romanticists on the other, two camps that disagree over the conditions that bring about development. A contemporary example of successfully developed economy, for instance, would be Turkey. Romantics reject the institutional separation between political and economic systems because they content that it leads to the atomisation of society whereas Westernisers support the imitation of Western path of differentiation by developing countries.

The 20th century economic debate in Germany

Anti-Liberal economists of the Historical School of thought adopted a nationalist perspective maintained that what Adam Smith had written for Great Britain was not applicable to Germany, as the conditions governing the Germans required another system. During the Golden 20s, the intellectual clash was radicalized while the economy developed rapidly, as it is especially in times of rapid institutional change that the clash between politics and informal mental models increases. What followed was the Great Depression, when most German economics became anti-capitalists. Von Hayek described the situation as an *economophobia* and spoke in favor of a planned economy. Peter F.

Drucker believed that “it is not that the standard of knowledge of the economists has deteriorated. It is the belief in the desirability and in the necessity of the sovereignty and autonomy of the economic sphere that is disappearing; and with the belief, the reality.”

During the 1930s, Social Market Economy opposed totalitarianism. In Western Germany particularly, Socialism was felt as needed while there was a general rejection of capitalism and a conviction that it was responsible for bringing about Nazism. Even the Conservatives were recommending nationalization of key industries. But market reforms were successful because Social Market Economy was not just a third way between socialism and capitalism, but one between Westernisers and Romanticists as well.

Walter Eucken, a typical Westerniser, published a very important article in 1932, one year before the Nazis seized power, when most Germans saw that a total State embracing all aspects of society was needed. Alternatively, Eucken had argued for the division between the political and economic sphere to ensure the protection rights. By that time, Müller-Armack was a Romanticist explicitly welcoming National Socialism as Nazism would make the State power borderless. After the German experience, he reverted to the Westerniser position and adopted a constitutional division of power between to State and, and the Freiburg School in particular. Müller-Armack preferred the approach that paid attention to sociological and religious issues, even if he conceded that the economist should be restricted to economic affairs. As a sociologist of religion, he understood that the task is not only changing economic affairs but everything in that society if reforms were to be accomplished. He stated that “although there appears in Germany occasionally the thought that what is needed is only a conscious unfolding of the competitive order and that this by itself will make it possible to bring social problems under control, it should have become evident by now that such a reliance on direct interaction will not provide for a solution on the task before us. The job does not merely consist in shaping an economic order, but also enquires its incorporation into a total life style.”

Putting the “social” in Germany

Social market economy is nothing different than a formula of integration, Dr. Zweynert asserted, because it stands for the community. It was the killer word against capitalism in Germany; even the National Socialists took advantage of this wording by getting “social”. But then international factors played in, those whose effects are controversial.

It would have been impossible in post war Germany to formulate economic policies without the Allies’ approval especially that they were increasingly able to formulate a common line in the cold war. As the Americans became dominant among the Allies, they were quite interested in implementing a liberal order in Germany. Yet, in the 1940s, the UK and the US’s dominant idea was Keynesianism while Germany was implementing a different liberal order than the Americans and their Keynesian advisors would have preferred. A general advantage of such a reform program is its likeliness to fit the shared mental model instead of a reform program developed by some American consultant. Dr. Zweynert concluded that the Germans were not very sensitive to American economic tastes and that, while they depended on international sponsors, their reform program was based on the mental models that they knew best.

Why did Russia Fail?

First, Russia lacked well-prepared local actors. Second, dissidents who were dreaming of 'socialism with a human face' were not ready for market reforms, as opposed to those in Central Europe who had adopted a Liberal underground discourse since the 1960s. Furthermore, Western consultants recommended to 'bypass' society by quickly implementing reforms instead of 'taking it along' and explaining the market functioning to the citizens. Due to Russia's experience during the 1990s, both markets and democracy are discredited today. The speaker predicts it will take a long time before the next attempt of reform can be undertaken. For that, he lists three preconditions for reform:

- 1- To pay attention to the general principles of political and economic order.
- 2- To adapt these general principles to the concrete conditions of time and space.
- 3- To make sure that political actors are able and willing to provide reforms for political space.

Plenary Discussion:

What is an economic system?

When participants challenged Dr. Zweynert's definition of an economic system, he explained his choice according to System's Theory: in a functionally differentiated society, each part works according to its sphere and within a particular medium. Prices are the language of the economic system because if two persons interact and talk about an economic transaction, they communicate in the form of prices, while not disclosing any personal information regarding the interacting parties. Thus, the whole communication is reduced to one piece of information excluding all non-economic data. By contrast, a centrally-planned economy disallows the debate around the transaction to be expressed in the language of prices. In this case, wealth depends on the proximity to the ruling party.

Others argued that understanding reality through the lenses of an economic system is narrow because it is too pure. Every market economy deals with politics. It was suggested that different models of economic systems are worth being investigated. State-led market economies, for example China and Japan, are very efficient and culturally compatible to the medium. On the other hand, the relationship between State and economy is much closer in Scandinavia than it is in the USA and England, yet it is still perceived as an economic system. The speaker contended that communication of prices is only one medium but there are thousands of other transactions, and that the employed definition of an economic system is only that of System's theory, but that many others exist. Ideal types are useful and necessary instruments to understand phenomena and see how the situation ought to be, and there is no reason to discard a normative approach.

The separation between politics and economics is a much debated issue. In a way, in every Western market society, politics and economics interact. The issue is: how do they interact? The institutional division of labor is useful, as these institutions provide order through dividing labor. By looking at the process, one cannot say that the workers are independent of each other since each of them fulfills one well-defined function. The same dynamic applies to the intersection between economics and politics. In the Lebanese case, politicians either run a business or directly redirect resources to their own benefits or that of their relatives. The political system is able to influence economic processes but it cannot do that while directly redirecting the resources.

The participants questioned the importance of a society's homogeneity as an influencing factor to the success of a social market economy. The speaker referred to the case of Switzerland which consists of three nations with different mental models that were nevertheless able to agree on a common mental model. Homogeneity is thus not a defining criterion.

The Social Market Economy provides an interesting example to developing a reform strategy, while being mindful of specific traditions and ideologies. Convincing the population of the necessity of liberal reforms can take place through experts living in these countries. The Western experts' role is limited to giving advice instead of dictating to the government what to do.

More on historical conditions

Participants expressed interest in learning more about the background of advisors in the historical context. The speaker elaborated that, during the time of Russia's transformation, the dominant theoretical approach in economics was the neoclassical paradigm which ignored the issue of institutions and the socio-historical context. This was also a problem for Russia, as the rise of Western economics was closely related to Russia's failure to reform. The Western consultant should not be blamed for giving bad advice; Dr. Zweynert contested that the blame should be placed on Russia that did not come up with a reform program on its own. The consultants of Russia and Eastern Europe had been involved in Latin American reform before; they learned then that a gradual reform program from the outside cannot cope with the influence on internal lobbies and therefore recommended to bypass society. It failed because of the restricted possibility to transfer experiences in one region and to apply them to another.

The crisis of the Weimar Republic led to the 1929 Great Depression, as its failure was the strong linkage between State and interest groups that monopolized and captured the government's decision-making processes. This is why Ordoliberalism postulate the division between State and Economy.

In Post-War Germany, domestic factors and American influenced interacted; the Cold War undoubtedly helped to liberalize Western Germany. Americans were convinced that turning Germany into an agricultural country was unsound. On the other hand, Russian consultants in the 1990s were in a completely different situation because they could not predict what the upcoming years would hold.

Would the German Economic Miracle have existed without the influence of the Americans? This is a difficult question. What is sure though is that in Germany, the success is due to a combination of internal and external efforts.

The State providing the liberal order is an idea of a benevolent dictator; what many economists criticize is the optimism of Ordoliberalism.

A strong holistic market economy might have been helpful, but it should have been slower, accompanied by a marketing strategy explaining how the market system works. Shock therapy was indeed successful in Poland and the Czech Republic but that was due to the fact that their Shared Mental Model was less anti-capitalist than that in Russia.

Are international institutions to blame?

“Don’t blame the international development institutions for the failure of domestic political and economic actors”, Zweynert stated. There lacks of counter power coming from the countries and regions claiming to be negatively affected. The IMF and the World Bank have learned their lesson. The Washington Consensus has been replaced by an institutional paradigm that better focuses on institutions and regional conditions. The accusations that these institutions are dominated by the United States are unfounded, he added. These are developmental institutions that connect developed countries trying to adapt their models to the recipient developing countries.

The similar situation applies to the World Trade Organization. it is not the task of international institutions to take into consideration local conditions of other countries. They cannot have the regional and local knowledge, and thus depend on locals to enrich them with recommendations to formulate reform strategies. Ordoliberalism is an open concept that views this local dimension as important to take into account.

Session IV: Culture and Market Economy

Presented by Dr. Helmut Leipold

1

The ongoing wave of economic globalization which has started in the 1980s and intensified until today has produced winners and losers amongst countries as well as amongst social groups within countries. According to different comparative studies of the World Bank and other institutions, one can count among the winners some 25 developing countries (among others China, India, Thailand or Bangladesh) with a total population of 3 billion people who were able to attain GDP growth rates of 5% and furthermore a reduction of poverty of large proportions of their population by opening up to world trade. On the other side of this development, there is a group of losers (among them African countries and Islamic states of the Middle East) whose economic development has stagnated, whose poverty has worsened and whose share in world trade has dropped. Most countries of Latin America are somewhat in the middle with moderate development rates.

2

These few indicators trigger the following questions: what are the basic reasons for the different paths of economic development and success rates? What are the chances or potential restrictions for a closer global convergence of the economic performance and especially the specific political and economic institutions? To what extent does culture matter? Are culture and religion relevant or irrelevant factors of economic development? This includes the basic question of this autumn school, namely whether the German concept of a social market economy could be compatible and partly transferable to the countries of the Middle East.

3

Concerning the first question (what are the basic reasons for the different paths of economic development and success rates?), there exists under economists since Adam Smith a broad consensus that different degrees of the division of labor, economic and technical specialization and market exchanges are the fundamental sources of differences in economic wealth and development. They determine the factor- and especially the labor-productivity and thus the amount of goods available for investment and consumption. This consensus corresponds with the insight that specialized production and exchange transactions depend on the existence of and the compliance with mutually shared and respected rules or institutions. The willingness to specialize and to barter requires a minimum of mutual shared trust. Trust means the subjective probability with which persons assess that other persons will perform agreements and contracts in a reliable manner. Here, the specific degree of trust only reflects the reliability in the existence of and compliance with mutual respected rules. As easy the causal relationship between economic welfare and the existence of reliable rules seems to be, as difficult was and is the solution to the economic and related institutional scarcity problem. The fact that mutually shared and accepted rules were missing or not accepted was until today a

basic experience of mankind. What are the reasons for a peaceful and productive solution to the ever actual problem of social and economic order? Why are rules not only precarious and why are there culturally different solutions to the problem of order? Let me start with my own answer.

4

The deeper reason for a peaceful and productive solution to the problem of order is rooted in the self-interested human behavior within different relations of the involved interests. As the German philosopher Immanuel Kant rightly remarked: everyone wants reliable rules and laws, but everyone also wants to exclude himself from their adherence. This incentive depends on the relevant structure of interests and especially on the degree of convergence or conflict of interests respectively. Relations of interests that are socially unproblematic because of the existence of common interests can be regulated or ordered by self-binding rules or institutions. Examples are conventions, habits or customs, which mostly evolve spontaneously.

5

A solution is much more difficult within relations of interests that are socially problematic because of the simultaneous existence of common as well as conflicting interests. What characterizes them is that the compliance with rules is individually not the most advantageous choice for a particular situation, but the second best alternative. The complexity of this structure of interests is explained best with the classic form of a mixed motive-game in the prisoners-dilemma-game. The structure of the involved interests requires individuals to limit their self-interest and to take the interests of other persons into account properly. Thus, it calls for moral commitments or bonds to one's behavior, in other words it calls for "institutions that require commitment". The solution to the problem of order is more than a pure problem of transaction costs, as it is conceived in New Institutional Economics. In essence, it is a problem of morality. The readiness for moral commitments derives mainly from non-pecuniary motives. It is necessary to consider motives like charity, compassion, social responsibility, sense of duty, justice and other ethical values. Thus, the essential argument is that culture, religion and history matter. Before treating these variables, let me try to answer the elementary question which motives or factors might enable self-interested individuals to accept and obey dependable moral commitments (=constraints or institutions).

6

I can only discern three sources or factors: first, natural (emotional) dispositions, i.e. moral sentiments as they were stressed by the classical Scottish moral philosophy (*emotio*). Second, religious beliefs into divine or transcendental values, as they were emphasized for example by Max Weber in conjunction with secular ideological convictions like socialism, nationalism or conservatism (*credo*). Third, critical and belief-independent reason with the capability to deliberate the social consequences of alternative rules and their compliance as it is stressed by representatives of enlightenment, social contract theories or modern institutional economics. This leads to a differentiation between emotionally binding, religiously or ideologically binding and legally (*vernunftrechtlich*) binding institutions. The first two of these ideal types of institutions

represent the core of informal institutions whereas the third type makes up the canon of formal institutions.

7

Since dependable institutional and especially moral commitments in social life of mankind have proven to be extremely scarce and continue to be scarce, the well-rooted texture of institutions that require commitment is probably the fundamental structure of any culture. Cultures are primarily distinguishable by their independent and grown texture of the basic informal and formal types of institutions, which lead to different capabilities and consequences for economic development and competitiveness.

8

The causal relationship between culture and economic performance is of course complex and not easy to disentangle. The difficulties begin with a proper comprehension and definition of culture. Some anthropologists counted about 150 concepts of culture. This might be perhaps a main reason why economists ignore to study such soft and hard-to-quantify variables like culture or religion. I prefer the cognitive comprehension of culture which actually represents the dominant concept. Culture is defined as a grown and intergenerational transmitted system or web of shared perception, meaning, understanding and signification of the world, i.e. the natural and social environment. It drives the daily behavior of persons who share this system. The specific characteristics of the cognitive comprehension are at best understandable from a Weberian perspective. According to Max Weber, culture derives from the inner urge of human beings to understand their world and to give answers of the basic questions of life, i.e. the origin, the order and the destiny of life. From this urge result time- and space-specific worldviews. The Weberian understanding corresponds to the concept of shared mental models as proposed by Douglass C. North. People construct simplified mental models and perceptions of their environment. They provide a common interpretation of the world including a prescription as to how the world and especially the community or society should be structured. Mental models evolve from cultural and historical heritage. Since status quo-conditions are the result of past decisions, a change of present conditions is always path-dependent. Therefore, history matters.

9

My explanation for institutional and economic change and development is again inspired by Max Weber. As a result of his comparative studies of different cultures and religions, Weber came to the following conclusion: *“Interests (material and ideal) and not ideas dominate the daily behavior of people. But the ‘world images’ that have been created by ‘ideas’ have, like switchmen determined the tracks along which action has been pushed by the dynamic of interests”*. I can not delineate the details of his theory of social and economic development, especially his widely renowned and highly controversial study *“The Protestant Ethic and the Spirit of Capitalism”*. The development of a capitalistic market economy requires the impulse to accumulation together with a rational organization of production and market-exchange processes. He recognizes as main sources for these requirements the ‘worldly asceticism’ of Puritanism and the idea of ‘calling’, i.e. the idea that the highest form of moral obligation of the individual is to

fulfill his duties in the worldly affairs. These ideas together with the Calvinist doctrine of predestination that only morally honest and industrious persons are chosen to be saved from damnation created the capitalist spirit.

10

Weber was aware that the protestant ethic traces only one side of the causal chain connecting religious and cultural factors to capitalism. In his later studies, he specified a number of additional factors distinguishing the European development from other cultures. These include the development of nation-states, administered by the rule of law and by specialized bureaucratic officials based on the existence of a rational legal and juridical law system, the systematical exploration of reality by autonomous sciences and the application of scientific knowledge into economic and technological innovations, the existence of free urban communities and other variables. His later studies of different world religions were intended as analyses of divergent modes of rationalization, as attempts to trace out the significance of cultural divergences for economic development. In general, Weber described the development of traditional and underdeveloped societies toward the modern extended, functionally differentiated and highly specialized societies of western style as a gradual process of rationalization, which refers to a gradual change of traditional holistic worldviews towards a functionally differentiated worldview with socially differentiated rationality-concepts. I see the great merit of his work in the discovery of religions as the decisive switchmen of institutional and economic change and development of cultures. The important influence of religions for the construction and development of ideas and thus of worldviews is self-evident. Unfortunately, Weber could not complete his planned study of the socio-economic impacts of Islam. I want to mention only one result of his superficial occupation with the Islamic culture: *“Not the Islam as the confession of individuals hampered the early process of industrialization. Instead it was the religious structure of the Islamic states, their bureaucratic administration and their specific legal system and juridical practice (Rechtsfindung)”*.

11

This leads to the final question of the relationship between Islam and economic development. Concerning this relationship, there exists a long and controversial debate. The arguments and explanations advanced by experts of Islamic religion and culture can be reduced to two positions. The first position may be labeled as the economic irrelevance thesis, the second as the economic relevance or disadvantage thesis. The starting point of the discussion were the empirical facts that the Islamic world was economically and technologically more advanced than the West until the 10th and 11th centuries. After this golden age it gradually fell behind and experienced a relative decline. Why the decline lasted so long, why Muslims were slow to industrialize and why the Islamic world remains, in spite of its oil and other resource wealth, economically relative poor and why the Islamic world, with a share of 22% of the global population, only contributes roughly 6% to the global social product. These few facts call for a serious explanation.

12

22

According to the arguments of representatives of the economic irrelevance thesis, these facts of economic decline and stagnation have nothing to do with Islam. The thesis is grounded on a systematic examination and interpretation of the economic and ethical prescriptions in Koran and Sunna as the two imported sources of Islam. This approach can be called as a source- or text-exegetic method. The Koran is economically not very specific, since only round about 10 verses of the Koran deal directly with relevant economic prescriptions and issues. The real ownership of all resources belongs to Allah. Private wealth and goods rightly acquired are legal, but individuals hold this property only in trust of God. Some verses encourage honest effort and enrichment and postulate to charge just prices, to pay fair wages, to make fair contracts and profits. People should not waste resources, should consume in moderation and pay voluntary poor dues (*zakat*). Some more direct injunctions concern rules against fraudulent trade practices, against gambling and speculation, against consuming pork and alcoholic beverages and last but not least the doctrine of the ban of interest (*riba*). The fact that some injunctions and especially the ban of interest have been routinely circumvented or substituted is used as the main objection against the relevance thesis. As the French Islam expert M. Rodinson concludes, none of the religious prescriptions and rules have constrained rational economic behavior. He claims that economic decline and stagnation were simply attributable to deficient political structures mainly created by European imperialism and colonialism. On the contrary, there are good arguments that Islam supports economic development. Seen from the perspective of the irrelevance thesis, Islam permits different economic orders with different degrees of individual freedom and state interventions, but leaves these degrees to the wisdom of those political leaders or people involved. All in all, Islam seems to accept tacitly a social market economy which avoids the excesses of a *laissez fair* economy or a state planned economy. Seen from this perspective, the German concept of social market economy should be compatible with Islam and partly transferable to the countries of Middle East.

13

The counterarguments from representatives of the irrelevance thesis derive from a critical examination and interpretation of the theological debates and dogmatization of the original sources after the death of Mohammed. The approach can be described as historical-critical or idea-historical (*ideengeschichtliche*) method which corresponds closely to the cultural approach in economics. In accordance with the irrelevance thesis, it is conceded that nothing or little can be found in the basic sources of Islam opposing social or economic progress. The critical point is the pretence of Islam to be in the possession of the absolute and exclusive divine truth, values and rules which are seen as eternal, timeless and thus unchangeable. The second critical characteristic of Islam is seen in the close alliance of religion, state, law, economy and other social systems (*Al-Islam din wa-daula*). Both points are made responsible for the ossification or sealing of the Islamic worldview und thus the Islamic culture and institutions. In early Islam, theologians and other scholars developed more or less free answers to problems that Koran and Sunna left unresolved. Open discussion helped sustain an internal engine of wealth and allowed a certain fluidity and openness of worldviews. Somewhere between the 9th and 11th centuries, free discussion ended, when it was declared that independent judgment and independent reasoning were no longer permissible, when the “*gate of*

ijtihad” was closed. The theological background was the debate over the controversial relationship and division between divine determination of the world and human self-responsibility as proposed by the school of rational theology. The early attempts toward rationalization of the *mutazilist* movement failed. As the German expert T. Nagel remarks, the Islam would have become another religion if the *mutazilist* ideas would have dominated. The closure of the “*gate of ijtihad*” meant that all answers were available and that people only needed to obey the divine directions and rules. In my terms: *ratio* was instrumentalized in favor of *credo*. In sciences, free discussion, rational explanation and problem solving were substituted by mechanic learning and memorization. The closure of the “*gate of ijtihad*” and the paucity of scientific research point to an intellectual environment inhospitable to the open exchange of ideas. The static and more or less holistic (*theonomic*) worldview promoted in the name of Islam proved remarkably durable because the broad public acceptance made it risky to promote new ideas and social change. Compared to the relative openness of the West’s public discourse, that facilitated the differentiation and rationalization of society, the division of *credo* and *ratio*, of morality and law and thus of economic development the Islamic world failed to develop.

14

The arguments of the relevance thesis do not presuppose that Islam is inherently inimical to social and economic development. But empirical evidence verifies the fact that until today most Islamic and especially Arabic countries face severe deficits in good governance and open public discourse. I only want to mention the famous “Arab Human Development Report 2002” (UNDP) written by Arabic social scientists. The deficits are at best confirmed by a set of indicators of “voice and accountability”. This set includes a number of indicators measuring political freedom, civil liberties, human rights and independence of the media. The Arab region reaches the lowest value of all regions of the world for these indicators. As the Report concludes, promoting of good government is necessary but not enough. A key driver of social and economic reforms is seen in the gradual change of ideas and in opening the public discourse. Higher levels of social and economic development cannot be achieved without improving basic aspects of the political, legal, institutional and educational conditions. This requires last but not least the reopening of the “*gate of ijtihad*” which was closed due to the chain of historical events for more than thousand years.

15

My final thesis is short and simple: if these only roughly outlined requirements can and will be fulfilled in different countries and regions of Middle East, the potential adoption and implementation of basic principles and elements of the concept of a social market economy should be no problem.

Questions:

- 1- *If culture is defined as a grown system or a web of shared meaning, values, ideas, this means a system of a shared world view as how the world society is structured and should be structured then the questions arises: what are the main differences between the Western-European (German) culture and the Islamic Culture?*
- 2- *What are the chances for a functional differentiation or separation of specific and autonomous social systems in the Islamic world?*
- 3- *Discuss arguments in favor of: the irrelevance thesis/ the relevance thesis concerning the relationship between Islam (Islamic culture) and economic development.*
- 4- *According to the concept of a social market economy, a strong state with an active economic and social policy should secure/ create a shared community of values? Can this idea be a realistic idea for the countries of the Middle East? Does a strong neutral state above the society exist? Is it thinkable?*

Plenary Discussion

Participants challenged the reference to an “Islamic Culture”, as national cultures arguably affect the character of Islam in different countries. The speaker agreed that “embededness” of Islam varies from one region to another. Indeed, Islam in Indonesia means another thing than in Morocco or Egypt. While analyzing the relationship between culture and economic systems, one should be aware that culture is a soft variable that is hard to quantify. Though religious thought is common in Islamic States because they rely on the same belief system (the Koran and the Sunna), various ‘sharias’ reach divergent normative conclusions. Nevertheless, religion and culture matter though are difficult to analyze soberly. Concerning the relationship between Islam and Social Market Economy, the speaker found no problem of coexistence. A look at the scriptures of Islam and the set of prescriptions reveals conformity with Social Market Economy. The drawback exists in practice in different States where identifying the real economic systems is a challenge because the State plays an important role by adopting different restrictions and regulations which are not in accordance with the principles of Social Market Economy.

Does economic development create culture or vice-versa? According to ideal thought (as opposed to materialism), culture is the first causal factor. In Germany, the debate between idealists and materialists has been longstanding. Dr. Helmut opts for Max Weber’s view that ideas pave the way for materialistic development.

Comparing Muslim States

Indonesia and Malaysia’s economies are dominated by Chinese minorities, is that why they are successful? What are the conditions for an active civil society where open discussion is acceptable? Where can scientists enjoy freedom of expression? How can a totalitarian State be changed? Could military competitiveness, economic decline or external pressures be instrumental?

One fear the speaker expressed vis-à-vis what he called the “Islamic World” was the insufficient openness; there needs to be more tolerance and openness especially compared with Asian countries in the scientific fields.

Is Islam incompatible with development?

Dr. Hanf added that he saw no incompatibility between Islam and Social Market Economy. The question remains whether or not Islam is conducive to development, to which he answered in the affirmative. With regards to minorities, he contended that though Malaysia and Indonesia do have an active Chinese minority, Europe also has a Jewish minority, but no one doubts Christianity as an impediment to economic development. The problem, he added, is not religion but historical contexts. Industrial development in Egypt started and was quite successful but slowed down with international pressure. The catastrophe was due to the 1948 War with Israel that led to militarization of States rather than their economic development.

The development of ideas is decisive and differs from a culture to another. The reformation was not a division between religion and state. The religious wars were about imposing the perceived correct interpretation of religion. Dr. Hanf expressed reservation vis-à-vis attaching the merit of secularization to the success of Christianity. He further states that the love story between democracy and Christianity is in fact a very young one; the Pope himself did not believe in sovereignty because it allegedly belonged to God. On the other hand, the Ottoman Empire was increasing technologically and embracing minorities such as Christians and Jews before European Christianity did so. The Ottomans enjoyed a huge area of control up to central Asia that enhanced trade, while Europe was gaining force through expansionism in the 19th Century and later settler States such as Israel. These events give far a more convincing explanation than any recourse theological constructs.

Conclusion: Scarcity of information

Dr. Leipold consented that economic success or stagnation was not only a result of cultural and religious factors. Nevertheless, besides political and economic factors, cultural ones which are difficult to explain are to be taken into account. This data should be considered, the speaker admitted, as he doesn't have a fixed explanation and would like to have a better grasp of reality. For instance, Islam postulates certain known values, but what an Islamic economic system truly is remains shady.

Session V: Economic and Social Policy in a Market Economy
Presented by Professor Thomas Apolte

Dr. Apolte of the University of Munster explained that his main concern pertained to hard facts of economic problems, economic and social policy shortcomings through Western European focus.

The longstanding fear associated with the European Monetary union is the occurrence of inflation, a phenomenon that has yet to take place. In contrast, Western Europe has enjoyed a relatively low rate of unemployment compared with that of Eastern Europe that has been higher and more persistent.

The role of the Government

Relation of labor market and social system could be topics of interest.

The speaker explained that economists have a specific view towards the role of government in the market economy, where a system of allocation and coordination works in principle without government intervention. The coordination of individual economic plans is done by a system ruled by price signals. If that is the case, why do we need the government for? The entry of the government into the market always has to be backed by a justification. Is it due to the need of reform of specific rules of the game? Or is directly intervention into the process of the market needed?

When the rules of the game are not structured as they should be, the markets cannot function. Whenever there is some sort of market, however defined, some specific rules will be needed to ensure efficiency. To do so, economists weigh market failure against government failure and accordingly decide on the strategy. Usual consideration involves some basic social services to be provided, especially in what is called a social market economy, where markets eventually serve social goals and competition prevents monopolization of systems of power. The government is thus needed to protect the underdog.

The Invisible Hand presupposes some rules of the game, which markets cannot provide efficiently:

- 1- Protection against crime
- 2- Definition and Protection of Property Rights
- 3- Enforcement of contracts
- 4- Provision of a legal system

Any intervention into the market is perceived as an encroachment on the freedom of the people; each of the activities of the government should be therefore be legitimized according to special criteria. For instance, excessive externalities that become a serious problem (for example environmental) require some government intervention in order to make everybody better off. Further, the provision of some public goods cannot be provided by the private market (due to internal and external security).

There is an assumption that everyone in the market is perfectly informed about the goods they are trading. Markets may indeed be plagued by inefficiency, and worse, complete failures, due to externalities, public goods, information asymmetries and indivisibilities.

To further explain information asymmetries, the speaker considered the “Lemons Problem” plaguing the market for used cars. Bad cars in the US are called Lemons. One side of the market has more or less perfect information about the quality of the product, while on the other side the buyer is in the dark.

The government needs to provide those who are unable to earn market income independently with social services. This is conditioned by:

- 1- A minimum income through some distribution
- 2- Old-age income may require at least some compulsory saving
- 3- The Provision with health-care services may be subject to market
- 4- A primary and secondary education is a precondition for equal chances and possibly for a peaceful society

Selected Fields of Economic Policy

- ***Monetary Policy***

Monetary policy increased in importance as the European common currency was established in January 1999, and Europe had succeeded in maintaining very low rates of inflation of a very long period for unknown reasons.

A stable monetary base would require a monopoly of the government in issuing currency, as it minimizes transaction costs of currency issuance. The debate today surrounds the role of the Central Bank: Should it be concerned strictly with price stability, or should it play a more involved role in the formulation of economic policy? The Maastricht treaty which established, *inter alia*, the monetary policy of the European Union, maintains in (art 105) that the “*Primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a*”.

So how is this to be achieved? The EU’s monetary policy is to keep the growth rates of the monetary base low by not printing too many bank notes. Still, there is no clear idea as to how to maintain price stability. While Alan Greenspan introduced a multi-indicator concept, different central banks have followed a different method, though eventually most of them have reached low rates of inflation during the last one and a half decades.

- ***Labor Market Policy***

A labor market is distinct from any other market. Its specificities include:

- 1- Specific investments in human capital (insider-outsider problems)
- 2- Asymmetric information on qualifications
- 3- Monitoring costs (hence efficiency wages)
- 4- Non-market clearing reservation wages due to welfare payments

The speaker introduced the Hump-Shape Hypothesis, which exposes the need to choose the degree of centralization of bargaining mechanisms which in itself affects wage growth. Low rates of unemployment countries don’t have very competitive markets. Germany figures very amongst the highest countries experiencing wage growth, while the degree of centralization of bargaining falls between that of the UK, the US and

Switzerland on the one hand, and Scandinavia and the Netherlands on the other. If wage growth is much higher than labor productivity, unemployment increases and institutions will be needed to keep track of both growths.

The average duration of unemployment is significant in this study. The situation in Germany is evaluated as dangerous because it has endured the longest period of unemployment among OECD countries. In fact, more than 55% of all unemployed in Germany are long term unemployed people¹, who are in majority constituents of unskilled labor.

Countries can be categorized under two main groups; those with

- 1- Relatively high wages of low-skilled workers, combined with high unemployment over a long period
- 2- Relatively low wages of low-skilled workers, combined Low unemployment

After WWII in 1948, Western Germany was suffering from a 12% rate of unemployment, coupled by a huge wave of migration from the East. By 1960, unemployment dropped to less than 1%. This development is a direct result of Western Germany's resort to Social Market Economy

- ***Social Policy***

Dr. Apolte claimed that most industrialized countries have developed welfare systems in order to provide a minimum income to all. While this is undisputed by most citizens, it comes as a cost: a transfer-based minimum income raises the reservation wage and tends to cause unemployment. For that, there are three ways for dealing with transfer-induced unemployment:

- 1- Negative income taxes or tax credits: they lower the implicit tax which applies when own income reduces the transfers
- 2- Low levels of transfers: they drive the reservation wage down
- 3- Relatively generous levels of transfers, combined with a system of control and of coaching: this aims at bringing the poor back into jobs (a strategy applied in Denmark)

In addition to managing unemployment, the government is undisputedly needed for the provision of old-age pensions. In most industrialized countries, the "pay-as-you-go" pension schemes are the main source of old-age income, followed by labor income, voluntary and compulsory pension plans. But these schemes will face problems, as demographic projections predict an increase in percentage of those over 60 years of age relative to the total population. Old-age pension reforms will be crucial to the success of the system. The speaker suggested three options:

- 1- Raising birth rates (an unrealistic choice)
- 2- Lower replacement rates
- 3- Raising the share of pensions from funded systems

¹ More than one year of unemployment

Plenary Discussion:

Challenges and Opportunities of Social Market Economy

“What is social about social market economy?” A basic yet difficult question to answer, admitted the speaker. He elaborated that a start would be to look at the historic genesis of the school to understand its success in Germany. Currently, most of the German political parties see themselves not as *a* party of social market economy but as *the* party which *invented* social market economy. Liberals, SPD, CDU etc have all avoided the words capitalism and free markets. The demand has overwhelmingly been on for market economy that does not serve the interests of the rich few but that of society as a whole. The matter of political marketing is also very relevant, as nomenclature wins or loses support just as well and defines the consensus of the importance of social market economy.

Can a Social Market Economy work for the Near East? The presentation exposed general criteria for the role of government and markets. On that level, there is not such a big difference between the two regions at stake. What becomes more difficult is reaching the consensus needed to establish the rules of the market and the scope of government intervention. As many degrees of freedom as possible should be left to the individual, and once this perspective has been agreed upon, an order can be reached. The US introduced democracy in Germany which had the worst political regimes of all time. This proves that democracy can flourish anywhere, though not necessarily stability.

Participants contested that, while in some markets, severe information asymmetry is produced by the market, but that the government itself could be responsible for that phenomenon. Dr. Apolte concurred that government intervention can create information asymmetry and as a result lead to market failure that is used to legitimize further intervention. But we have to live with information asymmetries constantly. From a perspective proposed by Von Hayek, markets are the best means to discover knowledge and information, to coordinate information and to equalize asymmetries. For now, economists have yet to find the proper type of intervention, as government failure is as flagrant as market failure. For that, criteria such as the role of democracy, corruption, the structure of State institutions and the like are to be taken into consideration. What we know almost for certain is that there is a correlation between democracy on the one hand and prosperity on the other. After the collapse of the Soviet Union, the countries that had a social market economy with democratic systems had better choices. Democratic systems tend to be more successful for establishing social markets and ensuring economic booms.

Are there cases of a market economy propelling developing countries forward? It is necessary to define what a market economy is, knowing that many its variations exist in most countries. Development depends on the precise rules of the game and the precise constitution that would make a country succeed in a particular way.

The case of Germany:

Participants challenged the priority attributed to price stability. The speaker argued that in the case of Germany, historical and political motivations played an important role.

Germany abstained from giving up on a stable currency after having ruined two currencies twice during the last century. Since World War II, it has had a stable currency. When it established a social market economy, Western Allies had exercised a considerable deal of influence. Eventually, the final decision was taken in Germany but nowadays, most countries are closely integrated in some sort of international cooperation (IMF, WB, EU...) Whether or not the role of international institutions is strictly beneficial is debatable. Whenever they develop guidelines that are not binding, they assist the government in legitimizing its reforms. The EU on the other hand, is attributed an estimate of 80 or 90 % of regulation of European economies. A lack of information of what the optimal institutional government structure and historical background should be is felt, but these factors are in constant change, so the optimal time for reform is in fact unknown. This is somehow forgotten by international institutions, which seem to develop institutional structures for eternity, blueprints of how it should be done now and forever. The EU suffers from the same assumption, and as it deepens and renders regulations more dense, it frustrates the process of change.

What are the time, factors and capacities needed for a transition to the market economy? First, stable institutions should be established; once this is done, a market economy will follow. The economic performance of Eastern Germany was indeed one of the worst in Eastern Europe, because it was not given the freedom to take decisions about its economic plans to come. Participants further inquired if more extreme conditions could motivate change, such as a crisis or a revolution. Dr. Apolte insisted that even if reforms had at some point taken place after a financial crisis or a revolution, this does not mean that they should be considered as agents of change. In Poland in the second half of the 1980s, the economic situation was critical. But it underwent incremental reforms towards a market economy and thus succeeded to develop first in Eastern Europe.

On the other hand, a command economy in principle requires everything to be nationalized. It is a myth to think that everything that is nationalized runs in a better way. In Poland, agriculture for instance was immune from nationalization for political reasons. But in the EU, protectionism is no longer in the hands of national governments but in those of Brussels. It fights protectionism within it but implements it vis-à-vis the rest of the world. Why? Because there is a lack of constitutional rules that prevent the EU from doing so. Germany can no longer pay subsidies whenever an industry or a business crosses the border of certain member-States.

Session VI: Democracy and Development in the Arab World
Presented by Dr. Samir Makdisi

Indicators of Development

Dr Makdisi introduced his presentation by affirming that whereas most regions of the world find a correlation between development and democratization, those in the Arab world do not, which is why an empirical investigation is appropriate. Some argue that the findings may not necessarily explain the reasons behind the lack of democracy in individual countries. Currently, sixteen researchers are working on case studies to understand the particularities of each country explaining why democracy has lagged. Lebanon being an exception in the Arab world, it shall be used as a benchmark.

The experience in the Arab world contradicts Lipset's theory that postulates greater economic growth leading to greater civil and political rights. The presenter maintained that an inclusive system is needed in order to reach good governance.

Has the Arab world lagged in terms of democracy? Empirical data drawn from Freedom House and Polity IV describe the varying degrees of political and civil rights. These indicators are nonetheless subjective and dependant on people's responses. The findings show that most countries are classified as unfree, and most Arab countries have low standards of human rights. Another index that is used refers to institutionalized democracy and authority, ranging from (-10) to (+10). The Arab world has consistently lagged behind in democracy ratings in the world, and waves of political liberalization did not lead to substantive democratic change. Attributes of democracy do not necessarily indicate a substantive application, as forgery is a widespread practice.

Oil and Conflict

The speaker presented two main findings: in terms of modernization theory, there should be a correlation between sustained economic development and democracy. In terms of socioeconomic growth, the region has increased over the others but is still lagging behind in democracy.

Democracy and external variables are varied; among which include per capita income, education and life expectancy. Historical variables are used to monitor change; in the Arab world, variables are of an ethnic, religious and linguistic nature. It is only when we introduce Arab specific variables that we notice the disappearance of the democracy deficit variable. The two fundamental ones are oil wealth and regional wars and conflicts.

Oil wealth

If 0.5 million Lebanese work in the Gulf, it is not surprising to see the government taking into account Gulf needs in its foreign policy formulation. This, however, is not noticed in Norway, for instance, that despite its oil wealth enjoys developed institutions.

Conflicts

The end of conflict should lead to a process of democratization and settlement. The only region that has proven this correlation is the Arab world, "*La sawt yaala fawq sawt el maaraka*" (No voice takes precedence over that of the battle). Conflicts are

instrumentalized to suppress then needs for democratization. On the other hand, when G.W Bush plans to “parachute democracy”, he is equally doomed to failure.

Neither colonial legacy nor Islam explains the lack of democracy. The speaker argued that there is no inherent relationship between religion and democracy. Fuel Exports as a measure of oil wealth negatively affects democratization worldwide. The end of war as an isolated factor could eventually lead to democratization, but the interaction between conflict and oil leads to a hindrance of democracy.

What about Egypt and Jordan, where oil is not as asset? Countries in the Arab East have been exposed to the Arab-Israeli conflict more than those who are further away. It would be useful to examine the effect of neutralization of the oil and conflict effects on policy. For instance, why is it that oil and conflict don't affect Algeria? Because it enjoys a diversified economy, not solely depending on oil, and has removed itself from the Arab-Israeli conflict.

When one is to understand what has hindered democracy, one should go beyond oil and conflict. Cooption of the elite by the ruling classes, religious divisions, and adverse neighbor effects, outside intervention, familialism, fear of Islamist extreme groups and persistence of colonial institutions all hinder democracy.

The Arab democracy deficit seems to contradict the modernization theory (Lipset) which associates greater economic development (higher per capita income , rising educational standards, greater life expectancy) with increased political and human rights, i.e. increased democratization. And the Arab experience stands in contrast with what other regions have experienced. For that, the speaker chose the case of Lebanon to elaborate his argument.

The case of Lebanon:

After independence in 1943, the application of the European invented consociational democracy was expected to beget stability. By adopting that model, different weights were assigned to different communities, and per Capita economic development, educational standards and social conditions increased.

Measures of policy describe numerically the quality of governance in Lebanon. The country scored 5 out of 10 between 1970 and 1974. To a certain extent, Lebanon has had its time of freedom of thought, expression and civil liberties. The question remains why that partial democracy has not fulfilled itself into a full-fledged democracy yet. Many differences can be noted over the last decades. Sectarianism appears to be powerfully negative when combined with intervention by outside 3rd parties and leads to the disruption of government. Furthermore, the authoritarian regimes in the neighborhood have not contributed to the betterment of Lebanon. Other factors exist as well, but models cannot take them into account; the importance of traditions of civil liberties, which have so far prevented Lebanon from sliding into authoritarianism, is emphasized.

But the lethal interaction between sectarian religious factors and outside factors led to the 1975 civil war. The inequality of civil political rights was a major goal as Muslims fought for greater political rights.

Challenges and opportunities:

Dr. Makdisi identified three main challenges:

- 1-a more embracing democracy,
- 2-a more equitable society,
- 3-a move toward a secular system: pending the attainment of this goal, a more equitable political participation on the part of political/religious groups.

As remedies, he suggested the following:

- 1- Enforce the pending provisions of the Taif Agreement: e.g. the National Commission for the Elimination of Confessionalism.
- 2- Re organize administration to give greater autonomy to local communities.
- 3- Draft a new electoral law that would lead to fairer representation of the country's political components.
- 4- Enforce a uniform civil code for personal status
- 5- Create the Upper House and facilitate the process of de-confessionalizing the political system

The above steps would facilitate public sector administrative reform and judicial reform and lead to more viable political institutions. The ultimate objective should be to move to a secular and competitive democratic model.

Plenary Discussion

The first question participants asked regarded how to abolish sectarianism, to which the speaker suggested safeguards, such as the upper house and a stop to the distortion of electoral results. People should feel that they have stakes in a more secular and institutionalized state. Institutions in the Arab world are in deep need of development.

The Arab-Israeli Conflict

Dr. Makdisi argued that the establishment of Israel was a political act with a complete lack of attention to the cultural background in which Israel was being established. Ignoring Palestinian rights will not solve the problems. Worse, the creation of Israel and the oppression of Palestinian rights is a precursor of fundamentalism. In fact, in the 50s, 60s and 70s, the secular movement in the Arab world was expanding, but then faced a sharp decline. But the Arab-Israeli conflict has often been used to ignore questions of civil rights, as a pretext to remain away from democracy. Participants contested that in Egypt, however, the relevance of the peace treaty with Israel was supposed to isolate it from the conflict, and yet authoritarianism is still aggressive in that country. The speaker conceded that Egypt's problem is not limited to Israel and the Arab States as bad governance cannot be a one-factored problem. Some wondered whether neutralization of the conflict should necessarily take place prior to political and economic development and the local level. The speaker found that there is no reason to abstain from investing in development while waiting for a regional peace agreement. In fact, development could well pave the way for proper conflict resolution.

Relative irrelevance of indicators

Democracy started in very poor countries with relatively low education (Switzerland and Iceland) while in the 1930s, Italy and Germany were highly educated and fascist. A historical comparative analysis suggests no precondition for democracy or a condition that disallows it. When another intellectual onslaught starts, democracy is postponed under the slogan “Security first, democratization later”. Today, terrorism is used as an excuse to postpone democratization. There has nevertheless always been a correlation between education and democracy, but the order of occurrence is still debated. People who advance in education see a better output in their lives if they see perspectives for themselves in a democratic system. Lebanon, and to some extent Kuwait and Yemen, enjoy a democratic checks and balances system. The Lebanese system has survived so far because nobody can win. In a deconfessionalized Lebanon, we will have another system of interest representation but within the same structure. The secular community is achievable, as 70% are in favor of choice for adopting civil law. But the behavior of sects is unlikely to change, so the enlargement of the possibility of altering the personal status law would be the alternative.

Some argue that since citizens will give up their civil and political rights in order to increase their economic standards of living, some would say a positive correlation between authoritarianism and development exists, such as the case in The East Asian Tigers. But no definite answer has been found in the literature which is quite divided over the issue, as freedom and democracy are values on their own that don't translate into national income figures.

Perspective and perception of the youth

It is not known if young people are already making an effort to change and to what extent they are uncomfortable with the status quo. So when we refer to “we” as the youth, it is not clear whether we are referring to the young educated men and women, the individuals in a certain age range, or other sub category. Participants say that they are from different educational, social and religious groups, yet they are all eager to contribute to the overall development of society. In general, people who are dissatisfied are either those who are apathetic or those who are trying to change it. So both pull and push factors are needed because the system is strong. There should be cooperation between those who are getting their hands dirty and joining the system and those expressing opposition from outside.

The new for new political parties and new alternative candidates to vote for is pressing. The youth of the Arab world, it has been said, is unaware of its rights and miserable situation. And therefore are not pressing for change. In Egypt, in contrast, a study shows that the new generation is willing for change, but of a more intolerant nature. Thus, defining the details of that change is necessary in order to avoid falling into dangerous generalizations. Some fundamentals include the need for free and fair elections, liberty of the media and an enhanced competition between different views.

What to do with sectarianism?

The political life in the Arab world is obviously in need for positive change, but organizations are ganging up against each other. Is the youth any different? The young generation aged 24 and less are as religious, if not more, than the older generation. In a 2003 study, the holiest places in Lebanon were Nabatiyeh and the Metn. There was no significant difference between religiosity of Muslims and Christians.

A significant majority believes that the communal feeling is so strong, that it cannot be eradicated, even though the same sample desires a secular State. But once delicate issues such as legalizing civil marriage and reforming privacy law are touched on, the majority expresses a resistance to change. A suggestion is to renounce wishful thinking of discarding realities, knowing that pluralist societies exist all over the world. The confessional divide in Germany led to non intermarriage for 450 years. Only since the 1960s have Catholics and Protestants intermixed. Homogeneity is not a problem that is a priority. Conversely, the following are:

- 1- Independent critical thinking
- 2- Education
- 3- Respect for minorities
- 4- Structural violence
- 5- Bad economic policies

A view for the future

After 1990, the Lebanese constitution was misused. But economic differences between different confessions have diminished. *De facto* discrimination against Shias ended at the end of the 1960s. Sunnis and Orthodox are slightly richer than other communities due to their urban setting. All in all, social equality is greater now than it used to be. Furthermore, contrary to the popular assumption, the political elite are formed of new families and have undergone proven reshuffling.

In conclusion, Dr. Hanf affirmed that single issue political movements have proven to be a success. The 2005 “Cedar Revolution” was centered on one precise objective: the withdrawal of the Syrian army and its intelligence services. The specificity of the cause increases the probability of success. The focus on one specific objective would therefore be a sound strategy for further change.

Primordial Entrepreneurs? Social Roots and Future Perspectives of Family
Enterprises in the Arab East
Presented by Dr. Boutros Labaki

The set the basic framework of presentation, Dr. Labaki introduced the topic by defining primordial entrepreneurs. According to him, the subjects are local entrepreneurs who are well rooted in their economic, social and cultural backgrounds. The geographic and time frames considered are the Arab East and the last two centuries.

Social roots of family Entrepreneurs in the Arab East

Economic roots:

Since the beginning of the 19th century, corresponding to the first expansion of Western capitalism in the Arab East as a consequence of the industrial revolution, local entrepreneurs were mainly importers, middle men between the local producer of raw materials and the local foreign importers, producers and exporters of raw materials, urban retail and whole sale traders, craftsmen, manufacturers, moneylenders, and later bankers, owners of engineering companies, private hospitals and schools of hotels, restaurants and land, sea and air transport facilities, tourist agents, construction and public work contractors, in addition to owners of cattle farms and agricultural enterprises. These types of family businesses were not all present in all the countries of the Arab East and at all the periods.

They developed gradually, with the expansion of Western economic activity in the Arab east. In the 19th century, these activities were mainly triggered by the needs of western economies for raw materials, markets for new industrial productions and lines of transports between Europe and America on the one hand, and Southern Asia and Eastern Africa on the other. These requirements led to the development of production, transport, financing and export of raw materials and semi finished goods.

Conversely, the need for new markets for Western-manufactured goods destroyed gradually, traditional manufactures and hand crafts, particularly in the 19th century in Egypt, Syria, Lebanon and Iraq.

But new family enterprises flourished in the fields of import export trade, production of semi-finished goods, and whole-sale and retail trade, money lending, banking, transport, hotels, restaurants, construction companies, education and health activities. The following century, particularly after the First World War, new categories of local family enterprise emerged in the field of manufacturing, modern agriculture and services.

Sociological roots

At the beginning, many of these entrepreneurs were local and urban, especially in Egypt, Palestine, Lebanon, Syria, Iraq, the Hijaz, Yemen, and the Arab Gulf. Further, between the 19th and 20th century, new comers were added to these categories: Yemenis, Hadramis, Lebanese, Syrians, Palestinians, Iranians, Iraqis, Omanis, and Indo Pakistanis in the Arab Peninsula. Simultaneous growth of rural enterprises was noticed in the areas of production and first treatment of raw materials, particularly in Lebanon, Syria, Palestine and Egypt.

An important part of the family enterprises in the Arab East and especially at the outset economic growth in each country belonged to religious and linguistic minorities. Shiites in Iraq, Kuwait, Eastern Saudi Arabia, Bahrain, Qatar, Emirates, Syria and Lebanon, at different periods were performing comparatively to Omani Ibadites, in certain Gulf countries.

As for Christians “shawams” and Jews, they were also active until the mid 20th century, notably in Egypt, Iraq, Syria, Yemen and Lebanon until 1975. The focus on religious minorities does not exclude the fact that Arab Sunnis also held active family enterprises, especially in Syria, Iraq, Palestine, Yemen, the Gulf Countries, Arabia, and Egypt.

Concerning ethnical minorities, we have to mention two categories: European minorities

Periodisation of the emergence and development of family enterprise

During the 19th century, modern family enterprises started to emerge most notably in urban and rural Lebanon, Syria, and Egypt. They grew in the fields of import-export and internal trade, transport, finance, agricultural production, and first manufacturing treatment of raw materials. During this century, their activity shifted toward the fields of finance, manufacturing transport and services.

The First World War damaged economic ties, as the area was entirely submitted to western political and economic control, as a result of the Ottoman Empire’s collapse in 1918.

The 1929 Great Depression deeply altered the situation. Worldwide recession heavily impacted the export of raw materials. New economic developments emerged to fill the gap, thus Egyptian, Lebanese and Syrian family manufacturing enterprises grew to replace cotton, silk and cereal exports. Merchants, local bankers and returning emigrants from overseas invested in manufacturing industries mainly to substitute imports.

During WWII, this process was accelerated because of the difficulties to export raw materials to Europe and to import manufactured goods from there. Import substitution activities were boosted to satisfy the needs of local markets.

The second part of the 20th century was characterized by important and radical political developments, notably the political independence of all the countries of the Arab East, the creation of the state of Israel and with it the Palestinian problem and the emergence of oil production in Iraq, Arabia and the Gulf. The political and economic liberation process was hindered as a result of the 1967 Arab-Israeli War, the oil boom in the seventies and the lasting conflicts in Palestine, Lebanon, and Iraq starting in the late sixties. How did family enterprises deal with such developments? Between 1945 and 1960, family enterprises had characterized Arab Eastern capitalism.

In the late fifties and in the sixties, the nationalization process in Egypt, Syria and Iraq began, preceded by the agrarian reform during the fifties, which transformed big family agricultural enterprises into small and medium ones. In Syria, nationalization began in 1958 with land reform and in the sixties with the nationalization of big family enterprises (banks, insurance, manufacturing industry, services, etc).

In Iraq, the 1958 revolution led to the nationalization of agricultural family enterprises the following decade. As a result of the nationalization process, big and medium family enterprises disappeared while a part of their capital fled mainly to Lebanon and other

Arab, Western, African and Asian countries. Part of the skillful entrepreneurs left the countries, a phenomenon that Lebanon took advantage of.

From the beginning of the seventies, new developments accelerated in the oil producing countries of the Gulf and the Arabian Peninsula. The growth of the oil income accelerated the development of the local family enterprises in Kuwait, Saudi Arabia and Bahrain, followed by the Emirates and Oman. Practically all the enterprises established were family owned, and in many cases several families put their funds and skills together to develop enterprises.

In the non-oil producing countries, privatization restarted in the early seventies in Egypt and Syria, and twenty years later in South Yemen, triggering the development of family enterprises. In countries like Lebanon, and in spite of the 1975 war, family enterprises succeeded to survive. Small family banks tended to disappear after the Intra Bank crisis in 1966. After the collapse of the Soviet Bloc, the privatization mood took over radically in practically all the Arab Eastern countries. Egyptian, Jordanian, Saudi and Lebanese family enterprises took advantage of the winds of change, alongside multinational corporations.

Several coexisting trends characterize today's family enterprises. Privatization is boosting their development and the appearance of new initiatives. Conversely, globalization is exposing them to competing foreign and Arab capital. Inside the Arab Eastern countries, small and medium enterprises are concentrating, such as the banking and air transport and other sectors in Lebanon. Oligopolies are also limiting the development of family enterprises

Present problems and prospects of family enterprises in the Arab East

Until the beginnings of the 20th century, Eastern Arab family enterprises succeeded in maintaining the family structure of ownership and management on the parts of economies that they were controlling. Modern nationalism, import substitution industries, treatment of raw materials (cotton, wool, wheat, oil, sugar...) and the emergence of local banks all contributed to the need of more capital to finance the new activities. This was partly at the origin of development of stock markets, in Egypt and Lebanon, and the development of joint stock companies also in Egypt, Palestine Lebanon and Syria. More capital was thus crucial, and family enterprises had to open up to foreign investors. Since the seventies, the process of opening the economies to private and foreign activity on the one hand, and the relative availability of funds drawn from oil and financial activities, culminated to the emergence of financial markets in practically all the countries.

Thus, family enterprises in the Arab East face the necessity and the possibility to open their capital to non-family sources and are sometimes confronted by the dilemma between development and the loss of control on the one hand, and stagnation with firm control on the other.

But prospective development is in reach, as the market is expanding due to the rise of oil income, the labor is available due to selective immigration and capital is abundant and available. Further, family owned companies of all sizes can co-exist with big companies in banking, contracting, manufacturing, trade, and other sectors thanks to the protection provided by State for social and political motives.

Markets are expanding, but at a lower rate as labor is cheap, capital is relatively more expensive and skilled labor is often migrating. Privatization could be useful, but it concerns mainly big family enterprises related to the nomenclature and/or foreign partners.

In some sectors marked by oligopolistic structures, big companies are owned by the nomenclature of its proxies. In other sectors, globalization brought about concentration: non-competitive enterprises are wiped out by foreign competition.

After having developed over the last two centuries as a consequence of the gradual integration of Arab eastern economies in the world economy, family enterprises in the Arab East are facing different prospects for the future. After having been a basic factor in the private economy of these countries, these families owned companies still have a big potential in the Arab eastern oil countries. In the other Arab countries, it is not the case, especially not in Iraq and Palestine.

But this is another story.

Plenary Discussion

The participants expressed concern for small family businesses in the region, to which the speaker responded that possibilities for a prosperous future exists. But their losses increase the less connected they are, a situation that differed in the 20th century. Since WWII, the creation of new national-States brought about the implementation of policies that required political support for small families. In the 1930s, Brazil was controlled by an authoritarian regime that followed an Import Substitution Industrialization (ISI) model and could thus export more coffee. The same dynamic took place in Argentina but took consumer industries as a base. Syria, Egypt and Lebanon equally followed the same model in the 20th century. Lebanon then shifted towards an export-led industry. The Gulf, on the other hand, still adopted ISI (due to cheap labor) while enhancing the treatment of petrochemicals and steels.

Money and Politics

Big business owners are big players in the political game, how influential are they in developing economic policies that serve their personal interests? The speaker found this behavior normal, as lobby groups exist everywhere. The problem is that their interests often contradict with the general benefit of Lebanon. Are family businesses a modern manifestation of the concept of *Aasabiya*? Not to this extent. Wealth is not one of extended families but generally that of one household. *Aasabiya* presumes that wealth is shared over three generations.

The relationship between family business and enterprises and the establishment of the middle class in the Arab world for moderate income distribution however is interesting to study. In 1975, family enterprises contributed to a middle class with trade unions, free press, checks and balances. It started similarly in Syria in the late 1950s until the coup d'état steered development in another direction. . In all other countries, family firms had little or no contribution to the development of a middle class. Growth was generally related to political connections.

Why is the middle class an asset to democracy? The basis of that theory is that the middle class is not dependent on the state, thus enhancing the democratic nature of society. In the Arab world, economic success depends more on power than on efficiency, and we therefore cannot talk of a true middle class with a democratic impetus. In Lebanon, few small and middle enterprises still enjoy partial independence. On the other hand, big ones are more dependent on political support that frustrates fair competition. It is an illusion to think that if all are economically dependent, then democracy has a better environment to flourish in.

Most Lebanese prefer the State society and not a family based society, though the latter was functioning well. Would a political State society coexist with a family-centered economy? The Lebanese are mainly influenced by French political culture and have managed to suppress other cultures. If we had another colonial power as a multi-racial empire, we would have probably exposed another political culture. The Lebanese intellectual elite have been colonized by French political culture, where intervention is fashionable, and competition is a dirty word; so economic attitudes lack competition in this part of the world.

How to explain the connection between traditional families and warlords, and how to explain their legitimacy in economic terms? The warlords, which are the heads of militias, fall under two categories of populist and traditional leaders. Both types were integrated in the political system along with the money they had amassed during the war, and their financiers. The Syrian occupation greatly contributed to this phenomenon. Political party enterprises emerged, and they affect the economy by constituting oligopolies that can only be regulated through State intervention.

Some argued that we have managed to hinder the concepts of mobility and meritocracy in Lebanon. Dr. Labaki added that the development of family enterprise has two contradictions: family enterprise growth is a factor of social mobility, and immigration and the expansion of the State were main factors for instance in 1997. Surely small and medium enterprises are engines for economic growth. Both experiences in the West and the Near East testify this relation. But separating ownership and management is very hard. But when growth brings about separation, the experience usually shows more development.

Session VII: Can a supranational market economy be social?

The Case of the European Union

Presented by Dr. Dominik Hanf

This question goes beyond the EU because it concerns supranational market integration. In fact, the questions are whether market failure should be defined at the supranational level, whether the EU is truly a market and does a supranational market exist?

Founding member-States pursued political unification and integration in order to ensure peace on a continent that had broken out into several wars. Although member-States were able to cooperate closely, they were unable to forfeit their national sovereignties, a stance that, in the 1950s, prohibited the European Defence Community from materializing. Economic integration therefore came as a substitute. At the beginning of the 1950s, at the time of the establishment of the coal and steel community, these resources were strategic assets, comparable to oil and gas today. The creation of a single market was expected to work under the same conditions of a national community.

The question is: has the objective been achieved? Only to a limited extent, the speaker argued. One cannot say that a solid single market exists. Though tariffs have been removed, sophisticated legal frameworks for trade have been designed, yet, energy policy, labor mobility (legal conditions are satisfied but in practice it is very limited) and economic policies remain to a large extent national. Even for those member-States that adopted the single currency, economic policies are merely coordinated while they remain basically national.

Although there is no real European supranational economy, we should ask whether the process of market integration has to take into consideration only economic factors. In fact, one can mention that most participating member-States have regulated economies which cannot be ignored. How has the EU taken into account the practical shortcomings attached to its means of integration?

Should non-economic aspects be taken into account? We should first distinguish negative from positive integration, and look at two factors: conception (rules) and practice (how to use these rules). The founding treaty of Rome strongly bases itself on free market, but a large number of provisions impede particular behavior of States and private actors.

Rules concerning competition policy also dictate State behavior on the market. This Policy prohibits private actors to interfere in the market in a distorting manner. In competition policy, the objective is to impede private companies from partitioning the market. All these rules taken together appear like codification of a free market, since those that negotiated the treaty played a main role in shaping competition policy.

Understanding the Treaty as an economic constitution

The European Court of Justice realized that these treaties included rights that challenge national measures which impede the individual's economic freedom, and often moved to invalidate many national rules that did so. As a result, the Commission made proposals for implementation of better rules. Furthermore, international trade law safeguarded free market principles while preserving exceptions. One is that the national system of ownership would not be affected by the free market: States remained free to organize

their sectors along private/ public lines. Though contradicting the philosophy of integration, French President Mitterrand nationalized some industries in breach of the spirit of the treaty but not its obligations. The Treaty thus only provided a framework.

Monopolies exist in some forms, though they should be organized in a comprehensive way without putting sectors under heavy State influence. For instance, water supply is of general interest and should be shielded from competition rules. But State aids are not legal unless they are justified on the basis of regional policy, problematic sectors, etc to balance between the free market and other considerations. Agricultural policy, on the other hand, shows that the free market is not the sole aspect of the treaty. These social policy provisions were aimed at balancing negatives of integration- securing workers from the consequences of integration.

Even in the original version of the treaty, the necessity for economic integration to take into account social aspects was clear. The system of supranational market integration is a combination of liberalizing trade while counterbalancing it with social policies. The easiest way was implementing customs union. Internally, indirect taxation protected domestic production while reducing customs. But it was problematic for States that had weaker tax collecting institutions.

There should thus be a balance between free trade and public policy objectives. But the free movement of labor presents more complications because, on the one hand. The community has set the rules for freer mobility but on the other, there remain problems, namely the free movement of students from one member-State to another and the free access to universities abroad. Today, however, higher tuition fees are no longer legitimate for foreigners after the Court of Justice's decision that university education belongs to professional life and enters under the labor market. On the other hand, this is often not enough.

There are very few legislative decisions by which the community would grant free access or the application of the free market through judicial decisions. Free market is more or less ensured by the community while social policy is structured by the member-States to provide the balance.

Competition policy always took into account non-economic aspects. In the previous years, it was thought, along with State subsidies, to be too sensitive of an issue. But social policy enormously developed it and covered several different aspects. Rules on paternal leave, part-time workers, pregnant women, consumer and environmental protection, workers decision-making in the company etc all became relevant during the liberalization process.

The speaker concluded by stating that the mechanism to balance the extension of the free market is much less clear today. The new member-States do not want to have prerequisites on labor and other criteria they consider constituting comparative advantage. But in fact, the history of EU confirms the fact that the division between free market and social policies are quite artificial. They should be treated holistically within a social market economy.

Plenary Discussion

Is a social orientation or are social aspects necessary in a process of integration? Is the EU more concerned with economic efficiency than with social policy? The argument made was that the economy has a social end; those who are left behind should be protected in the transition period of unemployment. For political reasons, policy makers should also make it most acceptable to the population's mental model by ensuring social safety nets. There is a clear necessity for coordination through collective bargaining at a national, federal and business/sectoral level. Because of the collective bargaining, workers are willing to lose on the short run because they know that they are aware of the long term benefits such as securing incomes coordinated between business and the State, social protection, vocational training, unemployment benefits, health care, education and EU international standards of labor rights.

The question whether the European experience should be a model arose. The Coal and Steel community should be compared with the Common Arab action for oil. Only in the 1973 oil crisis did the actors unite over a common policy to achieve goals deemed important by society. Experiences in one region cannot be replicated in another. EU integration was interpreted in two different manners: political (fear from falling back into war) and economic (the Coal and Steel Community). Did they go hand in hand? How can we look for copying the model and its steps? The assumption that Europe succeeded at integration because of stability is not accurate. It had been plagued by many wars, borders were in constant change, and countries appeared and disappeared overnight. Germany has proven that even with international intervention, creative politicians willing to introduce the proper policies are needed.

The participants expressed worries with regards to the discrepancy between shaping the rules of the game and their outcome: for instance, legislation for labor mobility exists but is not coupled with practical necessities. To what extent is the law enough to make a required phenomenon functional? Further, the fact that the regional court decides on a particular case is interpreted into rights. But the role of the judiciary is to interpret the law and not to write it. When the European Court of Justice pronounces itself on a particular matter and the judgment becomes translated into rights, this indeed shows that the judiciary is affecting the work of the legislature. To what extent is that democratic? For the first time in the history of international integration did the law play such an important law in the cooperation among States. Law, and not just ordinary international conventions but a particular sort of law was central to the EU. The rules adopted apply equally to States and markets. Implementation has been secured by the fact that the interpretation is centralized, since it is monopolized by the European Court of Justice. But this alone is insufficient: national courts are needed to cooperate with the ECJ, which has so far been a success. The mechanism that was established proved to be successful. Member states tend to be lazy at harmonizing international law with their municipal law. For that, the ECJ has developed a doctrine that allows the application of directives even for those who have not transposed new legislation to national law. Individuals who suffered some damage due to lack of observance of member States can claim sanctions of failure of member States. This has been widely accepted. But decision-making in the

union requires consensus. And if the EU is considered as a model for supranational economic integration with the help of a legal construction, one has to be aware of its success and the need for member States to adopt the law.

The future trends and challenges were summarized by the presenter. The new members of the EU are receiving a lot of aid and undergoing distribution on another level but less than the Southern European States. New entrants to the EU feel that freeing the market is detrimental to their interests especially because of social policies of low standards. The peculiarity of these States is in that their transformation economies underwent painful restructuring (loss of jobs and security) nevertheless making them stronger than older member-States, after their relatively successful rehabilitation process. But insuring acceptance of integration needs constant balance and thus adaptation.

One of the key questions which have to be resolved in the European Community is that of coordination. "How to define common standards accepted to all?" asked a participant. Dr. Hanf talked of minimum harmonization measures. The problem arises when this difference between minimum and maximum levels becomes so important that it turns into comparative advantage and limited resources. The real problem is where to set the level. In the end, you need institutions for economic integration as it is a completely political unification with common interests, trusts and definitions. An interesting example in Europe is the Benelux, compared with, say, NAFTA that enjoys neither common decision-making process, nor implementation mechanisms or an apparatus supporting the treaty in an effective way (i.e. a dispute settlement body). In the Middle East, horizontal integration can still take place, however it the lack of political will, and the "talk shop" that almost never amounts to anything.

Is the aim of national economic policies to avoid a market? It is highly unlikely that member States in the Union will abandon their power in terms of economic policy; they want to distribute the benefits. What can be done is a kind of division of labor. Dealt with the member States. Social policy and protection of party interest- this is also the basis for democracy. Public and social interest should be taken into account but those are mainly cost factors.

It doesn't make sense to establish social conditions in a weak economy if they are not to be applied because no entrepreneur will invest. A balance should be respected, and transporting standards from one area in the EU should be avoided.

The level of correlation between the economic and political sphere at the European level is exceptional while elsewhere the attempts to do so have failed, due to the lack of political will. Hegemonial integration processes throughout history were failed projects. Arab Unity was centered in Cairo, Damascus and Baghdad that claimed God's mandate to rule the Arab World, Napoleon and Hitler both tried to create Europe but it never worked because the counterparties were strong enough to oppose it. The lessons learned after that, especially post WWII paved the way for more incremental steps. The war of armies was replaced with a war of administration, in the exception of the former Yugoslavia.

Conclusion

No ready-made recipe can be sold to the Near East. The intention is to present a particular concept, born during a period of genocidal dictatorships, to explain and debate it. It is an example of an economy that offers particular attention to elements in society who are not equally fit to compete on the market, and have the right for a social network that offers the community stability and protection. The rule of law and checks and balances are key elements to this system's success. Ordoliberalism has rejected war and poverty. But neither Social Market Economy nor the E.U are preached as perfect concepts which could be consumed anywhere. Ordoliberalism is a model that can be a useful stepping stone for reform in the region It is up to the local experts in the Near East to contribute to sustainable development and ultimately a more prosperous and equitable society.